

**BEFORE THE
DEPARTMENT OF TRANSPORTATION
WASHINGTON, D.C.**

U.S. - U.K. ALLIANCE CASE

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) **Docket OST-2001-11029**
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ANSWER OF DELTA AIR LINES, INC.

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I. INTRODUCTION

By Order 2001-11-10, the Department consolidated the United/bmi and American/British Airways applications into the *U.S.-U.K. Alliance Case*. The Department found that “access to London’s Heathrow Airport is indisputably a central issue to both [alliances]” and that the proposed alliances presented major common issues concerning the “state of competition in U.S.-London markets and the impact of each alliance on competition in those markets.” Interested parties and the Department need to consider not only the reduction in competition that would be caused by granting antitrust immunity to either American/British Airways or United/bmi individually, but also the complex and interrelated impacts that approval of both alliances as a whole would have on U.S.-Heathrow and global alliance competition.

The critical issue before the Department is whether the approval of the two Heathrow alliances in tandem will produce anticompetitive consequences. The answer is decidedly “yes.” Delta’s recent answer in the American/British Airways docket spelled out in detail the serious adverse competition concerns raised by that alliance. The further consolidation of United and bmi at London Heathrow makes the competitive situation worse, not better.

Actual and potential competition on U.S.-London routes would be reduced, and control of Heathrow would be ceded to two overwhelmingly dominant alliances -- led by the same two U.S. carriers that already enjoy exclusive access to Heathrow. American and United, together with bmi and British Airways would control the overwhelming majority of commercially viable U.S.-Heathrow slots. Consequently, American/British Airways and United/bmi would dominate service on U.S.-Heathrow routes.

Because of the unique barriers that limit new entry at Heathrow, alliances between and among established Heathrow operators are particularly troubling. By combining the two largest U.K. slot holders at Heathrow in immunized partnerships with American and United, the entrenched Heathrow incumbents would marginalize new competitive entry and perpetuate their control and dominance of Heathrow to the detriment of competition and consumers.

In these circumstances, the attainment of U.S.-U.K. open skies would be an ironic and hollow victory. The competitive situation at Heathrow would go from “bad” to “worse.” First, all competition between American and its most significant U.S.-London rival, BA, would be extinguished. Second, rather than being a promising new independent competitor on U.S.-Heathrow routes, or facilitating U.S.-London competition through an alliance with one of the Heathrow non-incumbents, bmi’s proposed alliance with United would ensure that bmi’s competitive impact will be limited solely to strengthening one of two already dominant U.S. incumbents, making life more difficult for would-be new entrants and the Heathrow “have-nots.” Third, rather than enhancing global network competition, American/British Airways and United/bmi would be able to leverage their dominance at Heathrow to lock-up frequent business travelers and preclude other network carriers from offering competitive U.S.-London services.

Approval of the tandem Heathrow alliances would:

- Eliminate actual and potential competition on U.S.-Heathrow routes by combining the only two U.S. flag Heathrow incumbents with the largest U.K. slot holders at Heathrow.
- Increase concentration of commercially viable Heathrow slots and facilities in the hands of American/British Airways and United/bmi who would control the vast majority of U.S.-London Heathrow slots and facilities.
- Create a two-tier U.S.-London structure – those carriers that can offer frequent business travelers plentiful access to the most important gateway in Europe, and those that can provide only a token amount of U.S.-London Heathrow service.

- Prevent the formation of alternative pro-competitive Heathrow alliances. The combination of bmi (or BA) with any U.S. carrier except United or American would provide equal or greater network connecting benefits and significant new entrant competition on U.S.-Heathrow routes.
- Frustrate new entry and competition at Heathrow by incentivising bmi not to lease, sell or trade Heathrow slots with any U.S.-Heathrow non-incumbent (assuming the legality of such exchanges).

Although both American/British Airways and United/bmi point to the other as competitive justification for their own alliance, and the need for less stringent approval conditions, in fact the opposite is true. The United/bmi and AA/BA applications in tandem represent a dangerous combination because they would combine the only two incumbent U.S. flag Heathrow carriers with the two largest U.K. slot holders at Heathrow. This strengthens the incumbents' ability to dominate services in relevant U.S.-Heathrow markets, while, at the same time, decreasing the non-incumbents ability to secure slots and offer comparable levels of competitive service.

As Delta explained at length in its comments on the AA/BA alliance, the combination of two large Heathrow incumbents and the lack of slots and facilities at Heathrow are key impediments to antitrust immunity. Because United/bmi would combine two other large Heathrow incumbents and effectively take bmi's slots "off the market," the formation of this alliance in addition to American/British Airways would reduce competition and worsen the opportunities for competitors to operate U.S.-Heathrow flights.

II. THE PROPOSED ALLIANCE WOULD ELIMINATE BMI AS A STRONG POTENTIAL U.S.- LONDON HEATHROW NEW ENTRANT.

Contrary to the Joint Applicants' assertions in the United/bmi application, approval of an antitrust immunized alliance with United would eliminate bmi as a strong potential new entrant competitor on U.S.-London Heathrow routes. Rather than providing competitive, independently priced services, bmi would operate jointly with United. See, e.g. Joint Application at 16 ("United and bmi will coordinate pricing, inventory and yield management with respect to all services . . .").

The elimination of bmi as a potential competitor should be an important consideration in the Department's evaluation of the United/bmi application. This is especially critical because the number of large-scale U.S.-Heathrow potential competitors is extremely limited due to the scarcity of slots and facilities – resources with which bmi is particularly well endowed.

The Joint Applicants contend that "bmi is not a potential entrant into [the U.S.-London] market absent approval of this Joint Application." *Id.* at 5. The Joint Applicants seriously understate bmi's resources and competitive vigor:

- "bmi is a relatively small European regional carrier with a limited domestic U.K. and intra-European network." *Id.* at 3.
- "bmi would be unable to match the far more extensive resources of each of the incumbent U.S.-London competitors . . ." *Id.* at 3-4.
- "bmi's recent, limited entry into the U.K.-U.S. market from Manchester has been possible only because of its cooperation with United, which ensures, among other things, substantial U.S. traffic feed and sales and marketing support for the service." *Id.* at 4.

However, only two years ago when bmi sought its own exemption authority to enter the New York-London (Heathrow) market, bmi told a remarkably different story. Far from being a meek, anemic competitor –

- “British Midland has the infrastructure, route network, market identity and passenger base to ensure its successful entry into the transatlantic marketplace. No new entrant carrier, either British or American, can offer U.S. business and leisure travelers the resources, experience, connecting opportunities and fare structure that British Midland will bring to New York.” British Midland Application for Exemption, Docket OST-99-5671.

Contrary to views now expressed in the Joint Application, bmi was confident of its ability to enter the U.S.-London market and become a viable competitor outside the marketing umbrella of an antitrust immunized relationship with United:

- “British Midlands also has significant experience in marketing European destinations to U.S. passengers. British Midlands maintains its own sales and reservations services throughout Europe and in other major markets worldwide providing sales coverage, reservations service and support to travel agents in more than 50 countries. British Midlands is represented in the United States by a well-established sales and marketing representative which for the past eight years has operated a dedicated sales and reservations center in Phoenix (Scottsdale) on British Midland’s behalf. The dedicated reservations center permits United States passengers to book their travel on all of British Midland’s services. British Midland’s U.S. marketing strategy has met with considerable success. Current passenger sales in the United States account for approximately thirty-five percent of all British Midland passengers purchasing their tickets in off-line markets worldwide, making the United States British Midland’s second largest market after the United Kingdom. All of these resources will be brought to bear to insure the success of British Midland’s new services.” Id. at 7-8.

Significantly, the “overriding issue” British Midland urged the Department to consider in granting bmi special consideration for its proposed New York-London Heathrow service was British Midland’s promised ability to “bring fare relief and

added competition now to the single most important transatlantic market.” *Id.* at 2. British Midland postulated that by “providing lower fares in the JFK-London (Heathrow) market” bmi would precipitate a ripple effect in other U.S. –Heathrow markets. *Id.* Thus, according to bmi, “the importance which the major transatlantic carriers attach to attracting business class passengers is sufficiently intense that lower U.S.-London (Heathrow) business class fares are highly likely to spread to other markets following the introduction of British Midland’s service.” *Id.*

The prospect of bmi exercising price leadership and providing “low fare relief” for U.S.-Heathrow passengers evaporates if bmi falls under the influence of United’s pricing policies. Indeed, the elimination of bmi as an independent new entrant competitor would remove one of the legitimate benefits of U.S.-U.K. open skies. bmi is the only potential U.S.-London competitor with both substantial Heathrow resources of its own and the market presence necessary to mount a meaningful competitive challenge to the incumbents.

In 1999 bmi sought and was granted licenses by British aviation authorities to operate scheduled services from London Heathrow to New York, Washington, Miami and Boston. bmi was clearly interested in entering these U.S.-Heathrow markets and had the resources to do so. As an independent competitor, bmi would have provided critically needed service and price alternatives to those offered by the Heathrow incumbents on each of these important U.S.-Heathrow routes.

Instead, by entering into an effective merger with United, a potential competitor is eliminated, and consumers would face a post open skies environment dominated by the same U.S.-Heathrow incumbents as before. Competition would, of course, be much less if the parallel merger of American and British Airways is approved.

III. A UNITED/BMI ALLIANCE KEEPS THE DOOR CLOSED ON U.S.-HEATHROW COMPETITION.

The combined effect of the United/bmi and American/British Airways alliances is to ensure that, as a practical matter, new entry and competition on U.S.-Heathrow routes will be kept to an absolute minimum. While this may benefit the allied carriers, it is certainly not in the public interest. Delta's November 2 Answer examined in detail the competitive harm that would be caused by the combination of American and British Airways. The United/bmi alliance would exacerbate this harm by locking up bmi's Heathrow slots to benefit the only other entrenched U.S. carrier that already has substantial Heathrow access of its own. This would be a disappointing development for competition and consumers.

A. Other Carriers Would Have Provided BMI with Procompetitive Alliance Opportunities to Enter the U.S.-Heathrow Marketplace.

Prior to entering into an alliance with United, bmi was being actively courted by several major U.S. carriers. bmi could have selected another U.S. partner, *e.g.*, Northwest, US Airways or Delta - all without Heathrow access. Any of these carriers would have created a significant new procompetitive U.S.-Heathrow network with resources necessary to challenge the major U.S.-Heathrow incumbents on their own

turf. Instead, by linking with United, bmi selected the only U.S. partner (besides American) that would effectively reduce the number of U.S.-Heathrow competitors.

The fact that bmi chose United over a number of less restrictive competitive alternatives is itself evidence of the restricted nature of the Heathrow marketplace. By minimizing new entry and limiting U.S.-Heathrow services to just two primary alliances, the tandem United/bmi and American/British Airways Heathrow alliances would be able to exercise significantly greater influence on service and pricing on U.S.-Heathrow routes.

United's rationale for an alliance with bmi is transparent - this coalition will serve to strengthen United's position on U.S.- Heathrow routes. Indeed, in its comments on the last AA/BA proceeding, United pointed out that "local demand to and from Heathrow to points in the U.S. is significantly higher than in any U.S.-Europe market." UA comments, docket OST-97-2058 at 14. Like AA/BA, United/bmi is about capturing and dominating U.S.-London local passengers, not flow traffic.

Aside from restricted Heathrow access (which United already has) bmi adds little, if anything, to the Star Alliance. bmi adds very little in the way of online improvements to Star's massive European network. Star is the largest transatlantic alliance and already serves some 156 European destinations. DL-UK-11. bmi would add just eight unique new European points to the Star Network. DL-UK-12. As such, United/bmi fails to provide substantial air transportation network benefits. In light of

the availability of numerous less restrictive alternatives that would significantly improve U.S.-Heathrow competition, there are serious questions as to whether approval of this alliance would meet the Department's statutory public interest test under 49 U.S.C. §§ 41308 and 41309.

B. The United/BMI Alliance Would Result In Further Concentration of the U.S.-Heathrow Slot Pool to the Detriment of Competition and Non-Incumbent Carriers.

In commenting on the prior AA/BA alliance, United correctly recognized that the lack of viable Heathrow slots and facilities creates a serious competitive imbalance on U.S.-Heathrow routes that will not be remedied by an open skies agreement. *See, e.g.* Motion of United Air Lines for Evidentiary Hearing, Docket OST-97-2058, “. . . it is widely agreed that other carriers will need access to Heathrow airport. An ‘open skies’ agreement does not directly address such airport access issues.”

Carriers and alliance groups with access to scarce Heathrow slots and facilities will be able to capture a disproportionate share of U.S.-London traffic. The Heathrow “have-not” carriers will be relegated to distant third-tier status. As United explained before, “[American and BA] will continue to hold a substantial pool of slots that will enable them to increase service on U.S.-Heathrow routes as demand increases or to enhance the attractiveness of their combined services by offering multiple daily departures on hub-to-hub routes. . . . American and British Airways combined have the base of Heathrow slots needed to make these scheduling adjustments. Competitors do not.” Answer of United, May 22, 1998, Docket OST-97-2058.

United's proposed alliance with bmi – and its sizable Heathrow slot holdings – would give United/bmi a similar anticompetitive advantage that United complained about in the prior AA/BA proceeding. Delta agrees with United's previous observations that in order for other U.S.-London carries to remain competitive with the proposed Heathrow alliances, "they will also have to switch their services to Heathrow. However, without an allocation of Heathrow slots outside the normal allocation procedures, they will be unable to do so." *Id.* at 21.

While United may have solved its own Heathrow access problem by tapping into bmi's slot reserves, it is not in the public interest to cede control of U.S.-Heathrow to just two dominant alliance pairings. Under the present distribution of services, American/British Airways and United/bmi control 86 percent of all U.S.-Heathrow services, including 86 percent of New York-Heathrow, 83 percent of Boston-Heathrow, 100 percent of Chicago-Heathrow. DL-UK-1 through 7.

The combination of United/bmi and American/British Airways would concentrate nearly 80 percent of commercially viable U.S.-Heathrow slots in the hands of the carrier applicants their respective that would be unwilling or unable to part with them, (DL-UK-10) leaving an extremely small pool of remaining slots that non-incumbent carriers could possibly negotiate for (putting aside, for a moment, the uncertain legality of a mechanism for others to obtain Heathrow slots.). Thus, neither AA/BA nor United/bmi – nor any other Star or oneworld partner – would be willing to

negotiate with Heathrow non-incumbents for the sale or lease of slots suitable for U.S.-London service. As explained by the Department of Justice:

“Certainly AA and BA . . . will be unwilling to sell any slots to potential competitors at prices the competitor would be willing to pay. AA and BA know that any U.S. carrier would use a slot in competition with them on some U.S. route. As long as AA and BA can use the slot themselves, there is no possibility that a U.S. carrier can buy a slot from AA/BA. In essence, the U.S. carrier would not only have to pay AA/BA the scarcity rent (or opportunity cost) of the slot, but also the expected loss to AA and BA from additional competition, which would make buying a slot a poor investment for a U.S. entrant.” DOJ Comments, Docket OST-97-2058 at 21.

For these same reasons, no Star or oneworld partner would be willing to negotiate on commercially reasonable terms with the Heathrow non-incumbents for viable U.S.-London slots. bmi's proposed alliance with United removes any possibility that non-incumbent carriers might have had to reach a satisfactory bargain for slots with bmi, the second-largest Heathrow slot holder. Thus, approval of the instant applications would create two major U.S.-London alliances, with each alliance having both incentive and opportunity to lock out competitors at Heathrow airport.

IV. UNBALANCED U.S.-HEATHROW ACCESS FOR STAR AND ONEWORLD WOULD ADVERSELY AFFECT GLOBAL ALLIANCE COMPETITION.

The rallying cry of American/British Airways and United/bmi is that their proposed Heathrow alliances should be approved in the name of enhanced global network competition. However, because London Heathrow is of critical importance to frequent business travelers, but is also affected by unprecedented access restrictions, the Department must take special precautions to provide an even playing field for other

competitors if the Department elects to grant antitrust immunity to either or both of the Heathrow alliances. The combined strength of American/British Airways and United/bmi with their large reserves of Heathrow slot holdings -- would make it difficult, if not impossible, for other airlines to provide a credible competitive challenge at Heathrow without mandatory access guarantees. If Delta and other U.S. carriers (and their alliances) are not able to offer a credible level of U.S.-Heathrow service, their competitive position in the global alliance game will be seriously handicapped.

Delta's views were confirmed by Representative Oberstar, writing in his capacity as the Ranking Democratic Member of the House Committee on Transportation and Infrastructure, who expressed similar concerns:

“ . . .the increased domination of Heathrow by United and American will give them substantial marketing advantages over their U.S. competitors. Corporate customers and frequent fliers prefer to deal with an airline that gives them access to important destinations, such as Heathrow. To the extent the proposed alliance[s] will strengthen and entrench American's and United's domination at Heathrow, their competitors will be disadvantaged . . .” Letter to Secretary Mineta dated December 6, 2001.

V. SLOT DIVESTITURES ARE AN ESSENTIAL PREREQUISITE TO FURTHER CONSIDERATION OF EITHER OR BOTH OF THE HEATHROW ALLIANCES.

It is doubtful whether any conditions could be placed on the tandem Heathrow alliances sufficient to mitigate the competitive harm that would be caused by the massive reduction in actual and potential U.S.-Heathrow competition. In these circumstances, the best public interest outcome would be for the Department to dismiss or deny both sets of Joint Applications. However, should the Department elect to

proceed, an absolutely essential prerequisite to further consideration of the alliances is that substantial numbers of commercially viable Heathrow slots and facilities would need to be divested from the Heathrow alliances and made available to U.S. non-incumbents in order to replicate free market levels of competition.

By virtue of their long-term status as the exclusive U.S. carriers authorized to serve Heathrow, United and American already have a tremendous head-start advantage over their non-incumbent U.S. counterparts. American and United have been building upon their London Heathrow service advantage for years to amass a loyal group of corporate customers, frequent flyers, and the large numbers of transatlantic slots and widebody gates they now hold for U.S.-Heathrow operations. By combining their existing customer base with assets with British Airways' and bmi's enormous Heathrow resources, United and American would be able to use their restricted Heathrow service advantage to create a marketplace that is all but impenetrable to the U.S. non-incumbents.

If notwithstanding the competitive problems referenced above, the Department determines to approve the tandem Heathrow alliances, such an approval would need to be combined with conditions that will provide ironclad assurances that Delta and other new entrant U.S. carriers will have the ability to, in DOJ's words, "provide the level of airline service between LHR and the United States that would be expected in an open market." DOJ Comments (Docket OST-97-2058) at 2. It has already been well

established by Delta and others in this proceeding that sufficient numbers of Heathrow slots and facilities are not available in the marketplace. Thus, the slots and facilities necessary to fund new entry must be made available from one or both of the proposed alliances, which control the overwhelming majority of commercially viable U.S.-Heathrow slots and facilities. Delta has submitted evidence showing that in order to meet the DOJ's recommended divestiture condition to fund non-incumbent serves approximating an open marketplace, approximately 504 Heathrow slots would be required to fund 36 new daily flights.¹ DL-47, 48.

United/bmi and American/British Airways overlap on a host of critical U.S.-Heathrow routes, including New York and Boston. DL-UK-14. These are large, important O&D nonstop routes, affecting millions of passengers that would lose competition if the Heathrow alliances were approved. The Department needs to take strong action through remedial slot divestiture conditions to ensure that Delta and other carriers will have the slot resources necessary to provide a meaningful competitive response.

¹ In an open marketplace, Delta itself would operate at least eleven daily nonstop U.S.-Heathrow flights, including four daily flights from JFK, three daily flights from Atlanta, two daily flights from Cincinnati, and two daily flights from Boston. DL-48. In order to offer travelers the routing flexibility and time-of-day convenience that the alliances would be able to provide, Delta must be able to operate a full pattern of multiple daily services to be competitive for U.S.-Heathrow local and connecting passengers.

Non-incumbents also need the ability to offer Heathrow service from their major hubs in order to keep pace with the Heathrow alliances. American/British Airways and United/bmi would have substantial reserves of Heathrow slots to draw upon and are certain to provide multiple daily services on their own key hub-to-hub routes. As noted above, United's opinion is that the Heathrow alliance carriers "combined have the base of Heathrow slots needed to make these scheduling adjustments. Competitors do not." United Comments, Docket OST-97-2058. This would give the alliances huge advantages in terms of capturing U.S.-Heathrow passengers. The Department must ensure that non-incumbents have a fair and equal opportunity to compete by requiring the divestiture of sufficient numbers of slots from the Heathrow alliances so that non-incumbents can offer true open market levels of service.

VI. THE AMERICAN/BRITISH AIRWAYS LATE-FILED STUDIES AND DIRECT EXHIBITS FAIL TO DISPROVE THE SERIOUS ANTICOMPETITIVE IMPACTS OF THAT ALLIANCE.

In an effort to paper over some of the glaring competitive defects of their alliance, American and British Airways have recently sought to flood the docket with a barrage of "statements" and "studies" – many by unnamed authors. The Department found that "much, if not all of the material should have been filed as part of the application submitted by American and British Airways." Order 2001-12-5 at 4.

The Department determined not to strike these late-filed submissions, but instead to offer interested parties the opportunity to comment on them. A review of the AA/BA submissions demonstrates that they are of little use in evaluating it, and fail to

refute its substantial anticompetitive effects. A few illustrative examples serve to prove the point:

A. AA/BA Alliance Effect on Business Passengers “Appendix A Study”

The Joint Applicants submitted a study by an unnamed author claiming that the combination of the two primary U.S.-London nonstop competitors would not adversely affect prices paid by business passengers traveling between the United States and London Heathrow.

The thesis of the study is that, in addition to elapsed travel time, there are a number of other factors that influence business travel purchases, including corporate travel policies, prices and discounts, schedule convenience and quality of service, convenience of departing and arriving airports, connection reliability, schedule change convenience, and corporate discount programs.

While it is relatively easy to make general assertions in support of this thesis, the applicants have a far more difficult time showing that these factors influence U.S. - Heathrow passengers. Thus, when alleging that government authorities have recognized a blurring of the line for time sensitive and non-time sensitive passengers, AA and BA cite to the European Commission analysis of the United/US Airways transaction, not U.S.-London passengers (AA/BA Study, Section II.A., p.3). Similarly, when AA/BA claim that the DOT has determined that business passengers may select connecting services instead of nonstop flights, the applicants cite to the

Department's analysis of the Delta/Swissair/Sabena/Austrian alliance (Id. at p 4, footnote 6).

This flawed approach occurs throughout the AA/BA materials. Thus, in support of their general claim that corporate travel policies are driving business passengers to use one stop flights, the applicants cite to a general survey by American Express (AA/BA Study, Section II.B.2, p.8). While it may be true that there is an increase in the number of companies with formal written travel policies, what is uncertain (and not reflected in the submissions) is whether these policies effectively influence the purchase of U.S.-London, and more importantly, U.S.-Heathrow tickets.

AA/BA suggest that in an open skies regime connecting fares are likely to attract passengers from nonstop flights. (AA/BA Section II.B.3 p.11) In support of this postulate, the carriers cite to DOT studies that document the substantial decrease in fares and increase in competitive connecting services that have resulted from the development of transatlantic alliances. While this may be true for the vast majority of transatlantic alliances, it is most likely a reflection of the fact that in those alliances - as contrasted with AA/BA - carriers are free to enter and compete with the alliance airlines. Moreover, the experience of other immunized alliances operating in Europe are not indicative of the competitive circumstances of U.S.-London due to London's unique geographic position which makes it far less susceptible to competitive pricing from one-stop connection flights from Continental Europe.

Citing again to an American Express Survey, AA/BA explain that “the use of alternate airports is becoming increasingly common.” While such general statements are easy to allege, they offer little support for the AA/BA application and do not speak to the willingness of passengers to switch between London airports. Indeed, the evidence is to the contrary. DL-13, 14. AA/BA cite to a OAG survey for the proposition that the need for schedule change flexibility differs from passenger to passenger. (Section II.B.7, p. 15) Even if we accept this as true, the AA/BA analysis says nothing of whether business passengers will consider any carriers schedules other than AA/BA given the overwhelming combined dominance that an AA/BA alliance would have on customers traveling on U.S.-London routes.

Regardless of the general “factors” cited by AA/BA that may influence business travel decisions at the margins in other transatlantic markets, the unprecedented loss of competition on the U.S.-Heathrow overlap routes, combined with the unique circumstances that limit effective competition between the United States and Heathrow, will have a serious negative consequences for business travelers on these routes.

The Department of Justice and every other competition authority evaluating the alliance has recognized this to be true. Moreover, the impact of lost nonstop competition in this case is far greater than in any other previously considered alliance because of (1) the overriding and well documented preference of business passengers for Heathrow service (2) the lack of new entry opportunities at that restricted airport

and (3) London's geographic location which insulates it from competitive one-stop services via Continental Europe, due to excessive circuitry.

The analysis provided by the Applicants does not lead to the conclusion that AA/BA would be effectively disciplined by other carriers that do not themselves have attractive nonstop U.S.-Heathrow services. To the contrary, AA and BA's dominance of nonstop Heathrow service gives them a leg up in every other significant category the Joint Applicants claim is important to business passengers.

Schedule Convenience Because AA and BA would offer far more Heathrow flights from more U.S. gateways than any other competitor, AA and BA would have a lock on schedule convenience. Passengers in most major cities would have a choice of one or more AA/BA nonstop flights, plus the option of multiple daily connecting flights via one or more of American's hubs. British Airways alone serves 21 U.S. destinations nonstop from London, comprising 95 percent of U.S.-London traffic. DL-2. By spreading out departure times from American multiple U.S. hubs, AA and BA would be able to offer an unprecedented schedule array of U.S.-Heathrow flights. No other competitor could come close to offering the choice of arrival and departure times and schedule convenience of the alliance.

Airport Convenience Airport convenience is what this proceeding is all about – business passengers want to fly to Heathrow and airlines want to be able to take them there. Every major U.S. international carrier serves London, but only two serve

London Heathrow. Still, Heathrow accounts for twice as many total U.S.-passengers and three times more premium passengers than Gatwick. DL-13, 14.

Passengers do, in fact, opt for one-stop service over nonstop, just to reach Heathrow. This is evidenced by the study itself, which shows that some 22 percent of DFW-London passengers use connecting flights, notwithstanding the fact that American and BA both operate nonstop service to Gatwick. (P.21) While passengers in western states like Texas may have the option of a non-circuitous U.S. gateway connection, the major East Coast business centers where American and British Airways would dominate Heathrow service have no such alternatives.

Connection Convenience Although global alliances may have smoothed transfer connections, making it easier for passenger to make intra-European connections, the laws of geography still apply. It will never be a reasonable and practical alternative for U.S.-Heathrow business passengers to overfly their destination by hundreds of miles, make a connection on the European continent, then back-track to London. European carriers have not been able to penetrate the U.S.-London market, as demonstrated by their tiny (0.1 to 0.3) share of U.S.-London passengers. DL-24.

Corporate Travel Policies Although corporations frequently require employees to consider lower cost service options that meet their needs, such policies in their “guidelines and rules” also seek to avoid placing unreasonable demands on employees and wasting valuable executive time. Today, corporate travelers have a choice between

competitively priced services by two major nonstop U.S.-Heathrow rivals. If the Department decides to eliminate this competition, corporate travel policies will merely dictate that employees use AA/BA for U.S.-Heathrow services since those carriers will have unprecedented schedule convenience and U.S.-Heathrow service offerings that will dwarf the U.S.-London flights offered by competitors.

Corporate Discount Programs As the dominant carriers at Heathrow, American and British Airways will have a substantial competitive advantage in selling to corporations. Because AA and BA will offer many more Heathrow flights from many more U.S. gateways, corporations requiring comprehensive access to London – the most important business destination in Europe – will be drawn to the alliance, since no other U.S. carrier will be able to provide a comparable level of service. Moreover, as noted above, American and British Airways will be able to leverage their dominance at Heathrow to adversely affect competition for world-wide corporate customers because of the unique importance of being able to offer Heathrow as part of a total package of travel benefits.

Regression Analysis. According to the Applicants, the regression analysis in Appendix A was conducted to determine the extent to which business passengers respond to changes in relative published fares. However, there are several flaws in the analysis which make its value questionable at best. First, the Applicants disclose that these data must be interpreted with caution due to the small sample size and the fact that

fares are distorted on US-UK routes due to the pricing regime imposed by Bermuda II (Section 1, Paragraph 2).

Even more troubling are the reported results. The parties desperately seek a conclusion that U.S.-London passengers will switch from non-stop flights to one-stop service in response to a fare increase for non-stop flights. However, the Applicants find no US-London data that supports this conclusion for at least two reasons. First, they observe is no significance difference in US-London one-stop and non-stop fares (Section III.B, Paragraph 19). Second, while the Applicants argue that "It is reasonable to expect such a shift in shares of bookings in response to changes in relative prices" they must also acknowledge that there is no data to support that result. The only conclusion they are able to make is that "we do not observe such price variation in the data, due to the nature of competition on the US-UK routes as influenced by the pricing and capacity restrictions of Bermuda II" *Id.*

The parties also include as support for their alliance proposal a "Review of Recent Literature on Elasticity of Demand in the Airline Industry" in Appendix A.3, a "Critical Loss Analysis" in Appendix A.4 and a "Critical Elasticity Analysis" in Appendix A.5. But these submissions suffer from the same defects as the other materials included in the supplemental submission. They fail to account for the unique competitive situation applicable to U.S.-Heathrow services. Thus, in Appendix A.3, the Applicants acknowledge that their regression analysis "is complicated by the lack of

significant variation in the data as well as for other reasons discussed above”

(Appendix 3, p. 30) And while the Applicants suggest that “it is reasonable to expect such a shift in shares of bookings in response to changes in relative prices” the observed data provides no such support and they are forced to admit that “we do not observe substantial price variation in the data.” (Id.) However, the submission noted that it is merely a “suggestive estimate” of the results.

The parties cite to a study by Brueckner and Whalen in seeking to employ an assumed elasticity for their alliance (Id. at p. 30). But, as Delta observed in its reply in the AA/BA proceeding, Brueckner and Whalen themselves distinguished the proposed AA/BA alliance from the other transatlantic alliances as being in a category of its own. Indeed, those economists, while praising the impact of the other transatlantic alliances, said that “regulators are properly concerned about the anticompetitive effect of an AA/BA alliance.” Jan K. Brueckner and Tom Whalen, *The Price Effects of International Airline Alliances*, *The Journal of Law and Economics* October 2000 (p. 541)

In sum, the generalized analytical materials and studies provided by the Applicants do not render concerns for business passengers unwarranted. Citing to observations in other transatlantic markets do not take into account the unique competitive circumstances that are present on U.S.-Heathrow routes. To the contrary,

the loss of nonstop competition on U.S.-Heathrow nonstop routes is more, not less, important to business passengers with this alliance than with any other.

B. Appendix B Study

This study argues that tandem approval of AA/BA and UA/bmi would not result in a duopoly that would adversely harm competition. However, the analysis ignores two critical factors. First, the parallel approval of both alliances with antitrust immunity will result in a substantial reduction in actual and potential U.S.-Heathrow competition. Second, the analysis ignores the critical restrictions on Heathrow access for other airlines. The study simply *assumes* that new entrants will be able offer competitive services, stating, for example that “Delta will likely operate three non-stop dailies between Heathrow and JFK after Open Skies.” *Id.* at 15. However, to the contrary, the record shows that without a substantial divestiture of Heathrow slots and facilities in the amount recommended by Delta, non-incumbent carriers will be unable to marshal this type of necessary large-scale competitive response.

C. Appendix C Study

This study is provided to support the argument that Continental is an effective competitor in the New York-London market. The study claims that “As both the European Commission and the U.K. Competition Commission have properly concluded in prior proceedings, Heathrow and Gatwick Airports “operate in the same market’” That is emphatically *not* the conclusion reached by the European Commission or the U.K. competition authorities. Indeed, in reviewing the prior AA/BA alliance proposal,

the Commission's previous competition analysis correctly concluded that the American/British Airways alliance would substantially reduce competition on U.K.-U.S. routes and that barriers to entry exist that would impede U.K.-U.S. competition.

The Commission's analysis made the following key findings:

- "There are other European airports that have problems of saturation at certain times of day, but the difficulty is nowhere as intense as at Heathrow." Paragraph 166.
- "By combining the resources and infrastructures they have at [Heathrow] BA and AA will considerably broaden their scope for action on the relevant markets, whereas competitors will be hampered by the lack of capacity." Paragraph 169.
- "The combination of BA's and AA's frequencies will give the alliance possession of a high number and proportion of frequencies on numerous routes; competitors will not be in a position to offer a comparable number of frequencies within a reasonable lapse of time. This advantage will be reinforced by the fact that the alliance will hold a large number of slots, enabling it to increase the number of its frequencies if necessary, whereas owing to the lack of slots its competitors will not be able to do the same." Paragraphs 178 and 242.

The U.K. Office of Fair Trading conducted a thorough analysis of the alliance in 1996 and made the following determinations:

- "Although Gatwick serves more U.S. cities, Heathrow is much more important both in terms of frequencies and passengers and it is much preferred by business passengers. The two airports produce markedly different yields, with Heathrow leading, despite broadly comparable (published) fares." Paragraph No. 48.
- "Airlines which are unable to offer the same level of frequencies will thereby face a barrier to entry." Paragraph No. 68.

- “The economic power of the undertakings is further enhanced on the U.K.-U.S. routes in particular by the fact that the two airlines control a substantial proportion (65%, i.e., 490 slots per week - an increment to British Airways of 37%) of the slots used currently for transatlantic service at Heathrow, where capacity is constrained and demand far exceeds supply.” Paragraph No. 70.

As Delta has shown, Heathrow is a separate relevant market; it is the preferred airport to London for most passengers, particularly for business passengers. Indeed, in situations where BA and AA have authority to serve Heathrow and Gatwick, they provide service only to Heathrow and eschew service to Gatwick.

D. Appendix D Study

This study suggests that a frequency advantage resulting from the effective merger of AA and BA on U.S.-London routes would not give the alliance a substantial competitive advantage over other competitors. There are a number of analytical flaws in this paper. First, the study ignores the fact that non-Heathrow incumbents will have no ability to gain access to U.S.-Heathrow marketplace in the absence of a substantial divestiture remedy. Second, the economic analysis to support the analysis is based on data derived from the overlap U.S.-London markets from 1996 to 2000, where, for the most part, competing U.S. and U.K. carriers have strived to match each others level of frequencies. In addition, the analysis aggregates services to both Gatwick and Heathrow and does not separately evaluate Heathrow (which is a separate relevant market). Third, the analysis tries to show the correlation between frequency and "unrestricted passenger " bookings but appears to ignore the substantial amount of passengers

traveling on non-published fares, as was shown by the related AA/BA study. Fourth, the study runs counter to the study contained in Appendix A which indicates that the "number of frequencies" is an important factor in the passenger's decision-making process. Fifth, the study is belied by the scheduling practices of AA and BA. For example, in the NY-London market both carriers operate thirteen daily flights in direct competition with each other. Neither carrier has been willing to allow the other a significant scheduling advantage in that important market. After the merger of AA and BA, the carriers would be able to schedule even more joint flights between NY and London. It is not credible to assume that a new entrant such as Delta would be able to competitively discipline this massive alliance with only one or two daily flights. Indeed, the study shows that with respect to the critical NY-London route "for a given level of flight frequency, on average more unrestricted passengers fly per flight in New York relative to other cities considered..." Appendix D.1, page 13.

VII. CONCLUSION

The proposed Heathrow alliances between American and British Airways, and United and bmi, either alone or in combination would eliminate significant actual and potential competition on U.S.-London Heathrow routes. The addition of United/bmi exacerbates, rather than alleviates, the competitive harm that would be caused by approval of American/British Airways by itself. For this reason, these U.S.-U.K. alliance applications should be denied. If, however, the Department determines to consider these requests, then competitive access guarantees for Heathrow non-

incumbents become most critical, since the vast majority of commercially viable U.S.-Heathrow slots and airport facilities would be concentrated in two alliances led by the already-dominant U.S.-Heathrow incumbents.

If the Department does not reject the Heathrow alliances outright due to the substantial reduction in U.S.-Heathrow competition they would cause, at minimum the Department would need to condition any approval upon slot and facilities divestitures to non-incumbents so they can operate the competitive levels of service at Heathrow that would otherwise occur in an open marketplace.

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CERTIFICATE OF SERVICE

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